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In the Supreme Court of the United States

OCTOBER TERM, 1958

No. 585

NICHOLAS FERRAIOLO,
Petitioner,

v.

F. R. NEWMAN,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF OF RESPONDENT IN REPLY TO BRIEF FOR SECURITIES AND EXCHANGE COMMISSION AS AMICUS CURIAE

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We respectfully suggest that the Commission's brief was not filed on time and should be disregarded. Although Paragraph 4 of the Court's Rule 42 exempts the Government from the requirement of consent to the filing of a brief as *amicus curiae*, the Government is not exempted—and there is no logical reason why it should be—from the provision in Paragraph 1 that an *amicus* brief may be filed "only if submitted a reasonable time prior to the consideration * * * of the petition for writ of certiorari." The petition was filed on December 17, 1958, and at Respondent's request Petitioner consented to a thirty-day extension of the time for filing Respondent's brief, which accordingly

became due on February 16, 1959. The Commission's brief was filed on that very day—the day when the clerk is directed by Paragraph 3 of Rule 24 to distribute the papers to the Court for its consideration—which is hardly "a reasonable time prior to the consideration * * * of the petition."

The Commission not only had sixty days after the filing of the petition, it had five months after the decision of the Court of Appeals, to decide whether it agreed or disagreed with the decision. Indeed, the Respondent himself submitted a complete statement of the case to the Commission several years ago, many months before the case was decided even by the District Court. Notwithstanding all this, the Commission comes in on the very last day on which Respondent's own brief is due, making no excuses for its lateness and not desiring, apparently, to risk denial of a motion for extension of time.

The Commission's late filing is an imposition upon Respondent because the necessity of his filing two briefs has added to his printing costs as well as the work of his counsel. In this sense the harm has been done, because Respondent now has no choice as a practical matter but to answer the Commission's brief. Nevertheless, rejection of the Commission's brief would be a salutary demonstration of the reciprocal nature of the maxim that the citizen must cut square corners in his dealings with the Government.

If the Court does accept the Commission's brief, we respectfully request that it consider the following comments on it:

First: The Commission has chosen not to adjust the market prices quoted in its statement of the case so as to reflect application of the effective conversion ratio. The real relation of the prices of the preferred and common on the date of conversion was not 33⅛ to 36¼, as stated at

page 2 of the Commission's brief, but 33.01 to 33.18 (Joint App., p. 21a), the latter difference being the result of normal arbitrage. The Court could, of course, arrive at the correct figures by making the necessary computation from the conversion ratio stated on page 3 of the Commission's brief. But this is not the standard of disclosure which the Commission itself applies under the Securities Act of 1933. There it very properly insists that the prospectus may not be arranged "in such fashion as to obscure any of the required information or any information necessary to keep the required information from being incomplete or misleading." 17 Code Fed. Regs. §230.421(a).[1] Here the shoe is on the other foot. The Commission, especially when it enters a case as a friend of the court rather than a prosecutor, should be scrupulously careful to bring out all the relevant facts and all the relevant law. It has done neither here, and this is a further reason why its brief should be disregarded or heavily discounted.

Second: When we say that the Commission has not brought to the Court's attention all the relevant law, we have in mind particularly the sentence at the top of page 11 of its brief: "Until the decision below, the courts had uniformly interpreted the Act broadly and liberally to support this 'rule of thumb.'" This sentence, in context, creates a seriously misleading impression. The Commission has carefully culled every one of the unorthodox cases (those not involving ordinary trading) in which the courts concluded that there *was* a "purchase" or "sale" within the meaning of §16(b). But it either ignores or studiously obscures the fact that the Second Circuit (where most of these cases have arisen) has decided for the defendant

[1] It seems fair to observe that the Commission has actually issued stop orders "where the failure to limit or qualify an inexact statement at the very point where it was made was held to render the prospectus deficient, notwithstanding the statement was susceptible of correction from information supplied elsewhere in the prospectus." *Income Estates of America*, 2 SEC 434, 442, and cases cited.

about as often as it has for the plaintiff. See pages 7-8 of Respondent's earlier brief. Thus:

(a) The Commission in its note 7 carefully collects all the cases holding that the exercise of stock options does involve a "purchase." But it fails anywhere to cite *Shaw* v. *Dreyfus*, 172 F. 2d 140 (2d Cir.), cert. denied, 337 U. S. 907, where it was held that the issuance of stock to a director pursuant to stock purchase rights or warrants on the same basis as other stockholders was *not* a "purchase."

(b) The Commission at page 6 of its brief correctly cites *Blau* v. *Mission Corp.*, 212 F. 2d 77 (2d Cir.), cert. denied, 347 U. S. 1016, for the proposition that "the exchange by an insider corporation of stock of its company for stock of its less-than-wholly-owned subsidiary" does involve a "purchase." But the Commission—incredibly—fails to point out that the very same case held that a similar exchange effected when the subsidiary was still wholly owned did *not* involve a "purchase."

(c) The Commission's only comment on the Second Circuit's latest decision—*Roberts* v. *Eaton*, 212 F. 2d 82, cert. denied, 348 U. S. 827, the most important opinion of all because Judge Clark there produced a painstaking synthesis of all the prior cases—is consigned to a cryptic, and itself misleading, footnote (SEC Br., p. 9, n. 14).[2] Is there any conceivable reason for this belittling except that the court there concluded that a reclassification of common stock into preferred and common did *not* involve a "purchase"?

Third: The Commission is forced into this strange process of selectivity in order to support its thesis, long since exploded by the Second Circuit if it ever existed, that "*any* acquisition of a security pursuant to a contract right is, by

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[2]To answer one footnote with another, we must confess our mystification at the Commission's sole attempt to distinguish *Roberts* by referring to the court's emphasis of the fact that the insiders' position remained proportionately unchanged. There was likewise no proportionate change in Respondent's position in the case at bar when he merely converted his preferred stock into common.

definition, a purchase" (SEC Br., p. 7, with italics supplied). We could understand an argument—though we would be bound to disagree with it—that §16(b) *should* be so construed. But what the Commission is trying to persuade the Court is that it *has* been so construed—that the decision below is in conflict not only with *Park & Tilford* but also "in principle" (SEC Br., p. 6) with the Second Circuit's opinions in the other cases cited in its brief. The one principle which runs through these cases was made explicit in the latest of them, *Roberts* v. *Eaton*, in which the Second Circuit, after a thorough reappraisal of all the earlier cases, expressed its disinclination "at this juncture to attempt enunciation of a black-letter rubric." 212 F. 2d at 85. What the Commission would now have this Court do is precisely that—something which both the Second Circuit and the Sixth Circuit have refused to be enticed into doing. And in its search for the never-never land of legislative automation which has eluded every code drafter in history, the Commission ignores the many good reasons (enumerated in our earlier brief at pages 10-13) why a black-letter rubric here might well frustrate rather than further the very purpose of the provision in question.

Fourth: We agree, of course, that in most cases §16(b) operates automatically as the "crude rule of thumb" it was designed to be. We ourselves pointed this out at page 3 of our earlier brief. But surely it does not follow that a transaction not exempted by Commission rule under the last sentence of §16(b) is automatically covered. The bootstrap quality of this argument (SEC Br., p. 11)—which Petitioner himself abandoned in the Court of Appeals after making it in the District Court—needs no demonstration. There was no exemptive rule in *Roberts*, or in *Shaw*, or in *Blau* v. *Mission Corp.*

Fifth: The Commission states that options could be abused for manipulative purposes (SEC Br., p. 11, n. 16). We agree. *Park & Tilford* was such a case. The present case is not. It is no answer to point out that the *Park &*

Tilford opinion did not expressly take into account the unmarketability of the stock[3] or the absence of any protection against dilution. Courts decide cases as they arise, and take into account those facts which are essential to the decision of the particular controversy. *Park & Tilford* was a chapter in a crude market manipulation. If the present case had arisen first instead of *Park & Tilford*, the court might just as understandably have said (Resp. Br., p. 7): "We think a conversion of preferred into common stock followed by a sale within six months is *not* a 'purchase and sale' within the statutory language of §16(b)." And it would have been just as necessary to limit that statement when a case like *Park & Tilford* came along later. No court has divine prescience. Whether there is a conflict between circuits—whether cases are traditionally considered to be distinguishable in the common-law system—depends on actual variations of substance in factual situations, not alone on variations which are expressly taken into account in the first of two opinions. This, we take it, was Mr. Justice Harlan's point in the statement we quoted from his recent Cardozo lecture at the bottom of page 8 of our earlier brief.

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[3]The Commission's brief states (p. 9, n. 13): "The stock was unmarketable only in the sense that it was not traded on an exchange or otherwise actively traded, and that any public offering would have required registration under the Securities Act of 1933 • • •." This is quite an "only."

CONCLUSION

With Petitioner himself conceding that "the Court of Appeals drew the correct rule out of the cases but failed to apply it to the facts of this case" (Pet. for Cert., p. 20), it is difficult to see in the petition more than an attempt to obtain a second appellate review. The need for a second review has not been demonstrated either by Petitioner or by the Commission in its belated entry into the case. The petition should be denied.

Respectfully submitted,

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Counsel for Respondent

February 18, 1959